

ORIGINAL

MEMORANDUM

July 24, 1998

TO: DIVISION OF RECORDS AND REPORTING

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (VANDIVER) *W*

RE: DOCKET NO. 980307-WS -- ZELLWOOD STATION CO-OP, INC.
 AUDIT REPORT - ESTABLISH RATE BASE - PERIOD ENDED 12/31/96
 AUDIT CONTROL NO. 98-095-3-1

The above-referenced audit report is forwarded. Audit exceptions document deviations from the Uniform System of Accounts, Commission rule or order, Staff Accounting Bulletin and generally accepted accounting principles. Audit disclosures show information that may influence the decision process.

The audit was prepared using a micro computer and has been recorded on one diskette. The diskette may be reviewed using IBM compatible equipment and LOTUS 1-2-3 software. There are no confidential working papers associated with this audit.

Please forward a complete copy of this audit report to:

Zellwood Station Co-op, Inc.
 W.A. Restall
 2126 Spillman Drive
 Zellwood, FL 32798-9797

DNV/sp
 Attachment

cc: Chairman Johnson
 Commissioner Clark
 Commissioner Deason
 Commissioner Garcia
 Commissioner Jacobs
 Mary Andrews Bane, Deputy Executive Director/Technical
 Legal Services
 Division of Auditing and Financial Analysis (Devlin/Causseaux/
 File Folder)
 Division of Water and Wastewater (Walker)
 Orlando District Office (Forbes)

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Research and Regulatory Review (Harvey)
 Office of Public Counsel

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FPSC-RECORDS/REPORTING

ORIGINAL



FLORIDA PUBLIC SERVICE COMMISSION

***DIVISION OF AUDITING AND FINANCIAL ANALYSIS
BUREAU OF AUDITING***

Orlando District Office

ZELLWOOD STATION CO-OP, INC.

RATE BASE/INCOME AUDIT

PERIOD ENDED DECEMBER 31, 1996

**DOCKET NO. 980307-WS
AUDIT CONTROL NO. 98-095-3-1**

Handwritten signature of Richard F. Brown in cursive script.

Richard F. Brown, Audit Manager

Handwritten signature of Ian J. Forbes in cursive script.

Ian J. Forbes, Audit Supervisor

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**DIVISION OF AUDITING AND FINANCIAL ANALYSIS
AUDITOR'S REPORT**

JULY 15, 1998

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to audit the accompanying schedules of Rate Base, Net Operating Income, and Capital Structure for the historical twelve-month period ended December 31, 1996, for Zellwood Station Co-Op, Inc. These schedules were prepared by the utility as part of its petition for rate relief in Docket No. 980307-WS. There is no confidential information associated with this audit, and there are no staff minority opinions.

This is an internal accounting report prepared after performing a limited scope audit. Accordingly, this report should not be relied upon for any purpose except to assist the Commission staff in the performance of their duties. Substantial additional work would have to be performed to satisfy generally accepted auditing standards and produce audited financial statements for public use.

In our opinion, the schedules referred to above present fairly, in all material respects, the utility's books and records, which were not maintained in conformity with the accounting practices prescribed by the Florida Public Service Commission. The attached findings discuss all differences and other matters which were noted during our examination.

SUMMARY OF SIGNIFICANT FINDINGS

Utility could not substantiate or support plant-in-service of \$2,200,603.00 transferrable from the seller, Zellwood Station, LTD., at October 1, 1993.

Utility could not provide documentation to support \$68,111.11 and \$77,369.00 of pro forma water and wastewater operation and maintenance adjustments, respectively.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by examining, on a test basis, certain transactions and account balances which we believe are sufficient to base our opinion. Our examination did not entail a complete review of all financial transactions of the company. Our more important audit procedures are summarized below. The following definitions apply when used in this report:

Scanned - The documents or accounts were read quickly looking for obvious errors.

Compiled - The exhibit amounts were reconciled with the general ledger, and accounts were scanned for error or inconsistency.

Verify - The item was tested for accuracy, and substantiating documentation was examined.

RATE BASE: Prepared Zellwood Station Co-Op, Inc.'s water and wastewater rate base at December 31, 1996. Compiled all plant additions acquired from October 1, 1993 through May 31, 1998, and traced approximately 75 percent to supporting documentation. Recomputed the depreciation reserve at December 31, 1996, and May 31, 1998.

NET OPERATING INCOME: Compiled utility revenue and operating and maintenance accounts for the year ended December 31, 1996. Recalculated operating revenue applying the water and wastewater rates currently in effect. Chose a judgmental sample of operation and maintenance expenses and traced approximately 75 percent to invoices and other supporting documentation. Recalculated depreciation expense. Verified taxes other than income.

CAPITAL STRUCTURE: Compiled capital structure balances at December 31, 1996, and obtained a copy of the loan agreement funding utility investment.

OTHER: Scanned the federal income tax returns from 1994 through 1997. Read the St. Johns River Water Management District Consumptive Use Report.

Audit Exception No. 1

Subject: Utility Plant

Facts: The utility could not provide documentation (invoices and checks) supporting the transfer of \$210,781.00 and \$1,989,822.00 of respective water and wastewater plant-in-service.

Zellwood Station Co-Op, Inc. purchased the utility along with the mobile home park on October 1, 1993, from Zellwood Station, LTD., for \$13,600,000.

The \$2,200,603 allocated to the utility was based on a physical improvement inspection report conducted by a public engineer on February 25, 1994.

The costs allocated to the utility investment contained in the physical improvement inspection report could not be reconciled to the same per the company's books and rate filing.

	<u>Water Plant</u>	<u>Wastewater Plant</u>	<u>Total</u>
Allocated Purchase Price at Transfer	\$210,781.00	\$1,989,822.00	\$2,200,603.00
Additions 10-1-93 - 12-31-96	59,042.16	2,905.03	61,947.19
Utility Book Balance @ 12-31-93	269,823.16	1,992,727.03	2,262,550.19
Staff Adjustment for Transferrable Plant	(210,781.00)	(1,989,822.00)	(2,200,603.00)
Staff Balance @ 12-31-96	59,042.16	2,905.03	61,947.19
Utility Rate Filing @ 12-3-96	1,156,768.00	1,724,790.00	2,881,558.00
Adjustment	<u>(\$1,097,725.84)</u>	<u>(\$1,721,884.97)</u>	<u>(\$2,819,610.81)</u>

Opinion/Recommendation: Water and wastewater plant-in-service should be reduced by \$1,097,725.84 and \$1,721,884.97, respectively. Field staff defers to the FPSC engineer and analyst for disposition of the plant valuation at transfer.

Exception No. 2

Subject: Depreciation and Related Reserve

Facts: The water and wastewater reserve at December 31, 1996, along with test year depreciation, was recalculated per F.A.C. 25-30.140. Accumulated depreciation on the unsupported transferrable plant along with the associated depreciation expense (Exception No. 1) was excluded from the respective staff balances at December 31, 1996.

Opinion/Recommendation: It is recommended that accumulated depreciation at December 31, 1996, and water depreciation expense for the test year ended at the same date be reduced by \$239,519.12 and \$81,430.40, respectively; and that wastewater accumulated depreciation and depreciation expense for the same periods be reduced by \$294,738.54 and \$88,552.04, respectively.

Exception No. 3

Subject: CIAC and Amortization

Facts: The utility reflected \$250,000 of contributions-in-aid-of-construction (CIAC) at December 31, 1996, via its Commission-submitted rate filing.

A review of the company's records did not support the existence of CIAC. Utility representative informed staff that it has never collected monies from customers for anything other than monthly water and wastewater charges of \$17.50 per customer.

Opinion/Recommendation: It appears that the utility's consultants imputed the CIAC. It is recommended that CIAC be reduced by \$250,000 until the Tallahassee analyst and engineer value the transferrable plant per Exception No. 1 and determine the associated components. The related accumulated amortization of \$12,513 should also be reduced in total.

Audit Exception No. 4

Subject: Utility Pro Forma Adjustments

Facts: The utility was unable to provide field staff with schedules or documentation supporting \$68,111.11 and \$77,369.00 of 1996 water and wastewater pro formas, respectively.

Water and wastewater operating and maintenance expenses (O&M) including pro formas were \$169,841.07 and \$167,421.93, respectively, for the test year ended December 31, 1996.

The 1997 unaudited water and wastewater O&M expenses per the utility's general ledger were \$125,197.47 and \$156,770.82, respectively.

Opinion/Recommendation: Staff recommends that 1996 water and wastewater operating expenses be reduced by \$68,111.11 and \$77,369.00, and net operating income be increased by the same.

Exception No. 5**Subject: Filing/Per Books Reconciliation**

Facts: The following differences in O&M accounts were noted between the utility's Commission rate filing and its books (general ledger).

<u>Account</u>	<u>Description</u>	<u>Utility</u>	<u>Filing</u>	<u>Difference</u>
Water:				
601	Salaries & Wages	\$14,395.77	\$44,395.17	(\$29,999.40)
620	Materials and Supplies	1,652.94	7,304.53	(5,651.59)
631	Contractual Services-Engineering	3,564.80	0.00	3,564.80
633	Contractual Services-Legal	24,306.30	0.00	24,306.30
635	Contractual Services-Testing	1,230.00	0.00	1,230.00
636	Contractual Services-Other	4,116.38	1,230.00	2,886.38
675	Miscellaneous Expense	<u>2,600.02</u>	<u>1,259.78</u>	<u>1,340.24</u>
		<u>\$51,866.21</u>	<u>\$54,189.48</u>	<u>(\$2,323.27)</u>
Wastewater:				
711	Sludge Removal	\$13,210.00	\$0.00	\$13,210.00
720	Materials and Supplies	609.26	4,306.28	(3,697.02)
731	Contractual Services-Engineering	2,250.00	0.00	2,250.00
735	Contractual Services-Testing	4,256.50	0.00	4,256.50
736	Contractual Services-Other	2,376.21	5,042.00	(2,665.79)
775	Miscellaneous Expense	<u>2,401.07</u>	<u>1,042.28</u>	<u>1,358.79</u>
		<u>\$25,103.04</u>	<u>\$10,390.56</u>	<u>\$14,712.48</u>

Opinion/Recommendation: Staff recommends that water operating and maintenance expense be reduced by \$2,323.27 and wastewater be increased by \$14,712.48.

Exception No. 6

Subject: Consumptive Use Permit

Fact: The utility charged Account 631, Contractual Services-Engineering for \$3,564.80 during the test year ended December 31, 1996.

The \$3,564.80 billed to Zellwood Station Co-Op, Inc. by Excel Engineering Consultants was for services provided in processing the utility's application for its consumptive use permit (CUP).

The permit issuer, St. Johns River Water Management District, established a five-year CUP life.

Opinion/Recommendation: Field staff recommends that the \$3,564.80 charged to Contractual Services-Engineering be reduced by \$2,851.84 to reflect a five-year amortization period.

Exception No. 7

Subject: Utility Expensed Plant Additions

Facts: The following capital expenditures were charged to operations during the test year ended December 31, 1996.

<u>Account</u>	<u>Payee</u>	<u>Description</u>	<u>Invoice No.</u>	<u>Date</u>	<u>Amount</u>	<u>Depreciation/ Reserve @12-31-96</u>
736	Ryan Brothers, Inc.	Lumber for residing blower room	41019	2/09/96	\$433.47	\$12.42
736	Ryan Brothers, Inc.	Lumber for residing blower room	41222	3/06/96	154.10	4.01
636	TWC Distribution, Inc.	(12) Meter boxes	3611	2/16/96	<u>175.92</u>	<u>7.33</u>
					<u>\$763.49</u>	<u>\$23.76</u>

Opinion/Recommendation: Staff makes the following recommendations: that water and wastewater operating expenses be reduced by respective \$175.92 and \$587.57; that water and wastewater utility plant be increased by the same; and that water and wastewater test year depreciation expense and the associated reserve at December 31, 1996, be increased by \$7.33 and \$16.43.

Exception No. 8

Subject: Capital Structure

Facts: The utility purchased the mobile home park along with the utility for \$13,600,000 on October 1, 1993.

The seller, Zellwood Station, LTD., agreed to finance \$1,500,000 of the purchase price at 7 percent and received the balance in cash.

The utility reflected a 7.95 percent cost rate via its submitted filing applicable to the financing of the said loan.

Opinion/Recommendation: Long-term debt for the utility should be reflected at a 7 percent rate and the remaining investment as equity.

Exception No. 9

Subject: Working Capital Allowance

Facts: The working capital allowance has been computed based on the 1/8 formula method to comply with Commission rule 25-30.433(2), Florida Administrative Code.

The respective water and wastewater working capital allowance was computed as \$12,047.37 and \$13,022.23 based on staff-adjusted operation and maintenance expenses of \$96,378.93 and \$104,177.84.

Opinion/Recommendation: Staff recommends that water and wastewater rate base be increased by \$12,047.37 and \$13,022.23, respectively.

Disclosure No. 1

Subject: Pro Forma Plant

Facts: The utility reflected a pro forma adjustment of \$234,678 for meters during 1997, via its submitted Commission rate filing.

The utility acquired \$98,383.89 and \$49,448.11 of respective water and wastewater additions from the end of the test year at December 31, 1996 through May 31, 1998.

Meters and associated costs represented \$59,682.54 of the \$147,832.00 plant additions obtained since December 31, 1996.

Opinion/Recommendation: Staff reflected rate base as of December 31, 1996, exclusive of the meter pro forma. Staff traced \$96,959.27 of the \$147,832.00 to supporting documentation. Staff defers to Tallahassee analyst for disposition of this matter.

Disclosure No. 2

Subject: Nonrecurring Expenses

Facts: The utility charged Account 633, Contractual Services-Legal for \$24,306.30 during the test year ended December 31, 1996.

The \$24,306.30 represents legal services provided by Gray, Harris & Robinson for utility-related matters.

Field staff was unable to categorize legal expense as some items were inadequately descriptive. However, all costs appear to be specifically related to the FPSC rate filing, processing of the consumptive use permit, and the purchase of the utility.

Opinion/Recommendation: The legal costs should be amortized over a period as deemed reasonable by the FPSC analyst. A copy of the invoices totaling \$24,306.30 has been included in the audit work papers to assist the analyst in disposition of the matter.

Disclosure No. 3

Subject: Water Conservation

Facts: The St. Johns River Water Management District's issuance of Zellwood Station Co-Op, Inc.'s consumptive use permit was conditional upon the utility implementing certain water conservation measures. One condition was requiring water meters on all new construction and retrofitting such on existing residences. The retrofit program was required to be completed by the end of 1998.

Opinion/Recommendation: As of May 31, 1998, 690 of the 995 developed lots have been metered. In order to comply with the permit conditions, the remaining 305 need to be installed by December 31, 1998.

Disclosure No. 4

Subject: Allocations

Facts: Operating expenses, with the exception of salaries and wages, were distributed equally between water and wastewater, if not specifically identifiable with either operation.

Opinion/Recommendation: Utility representative informed staff that the allocation methodology was based on revenue billed to customers at a flat rate of \$8.75 for water and \$8.75 for wastewater.

EXHIBIT I

**ZELLWOOD STATION CO-OP, INC.
DOCKET NO. 980307-WS
WATER RATE BASE
PERIOD ENDED DECEMBER 31, 1996**

(a) DESCRIPTION	(b) PER COMPANY	(c) AUDIT EXCEPTION	(d) REFER TO (1)	(e) PER AUDIT
UTILITY PLANT-IN-SERVICE	\$1,156,768.00	\$(1,097,725.84)	E-1	\$59,218.08
		175.92	E-7	
LAND	0.00	0.00		0.00
CIAC	(250,000.00)	250,000.00	E-3	0.00
AMORTIZATION OF CIAC	12,513.00	(12,513.00)	E-3	0.00
ACCUMULATED DEPRECIATION	(241,276.00)	239,519.12	E-2	(1,764.21)
		(7.33)	E-7	
WORKING CAPITAL (2)	0.00	12,047.37	E-9	12,047.37
RATE BASE	<u>\$678,005.00</u>	<u>(\$608,503.76)</u>		<u>\$69,501.24</u>

REQUIRED FOOTNOTES:

- (1) *Audit adjustments do not include audit disclosures.*
- (2) *Working Capital was calculated at 1/8 O&M expense per Commission policy.*

EXHIBIT II

**ZELLWOOD STATION CO-OP, INC.
DOCKET NO. 980307-WS
WASTEWATER RATE BASE
PERIOD ENDED DECEMBER 31, 1996**

(a) DESCRIPTION	(b) PER COMPANY	(c) AUDIT EXCEPTION	(d) REFER TO (1)	(e) PER AUDIT
UTILITY PLANT-IN-SERVICE	\$1,724,790.00	(\$1,721,884.97)	E-1	\$3,492.60
		587.57	E-7	
LAND	0.00	0.00		0.00
CIAC	0.00	0.00		0.00
AMORTIZATION OF CIAC	0.00	0.00		0.00
ACCUMULATED DEPRECIATION	(295,277.00)	294,738.54	E-2	(522.03)
		16.43	E-7	
WORKING CAPITAL (2)	0.00	13,022.23	E-9	13,022.23
RATE BASE	<u>\$1,429,513.00</u>	<u>(\$1,413,520.20)</u>		<u>\$15,992.80</u>

REQUIRED FOOTNOTES:

- (1) *Audit adjustments do not include audit disclosures.*
- (2) *Working Capital was calculated at 1/8 O&M expense per Commission policy.*

EXHIBIT III**ZELLWOOD STATION CO-OP, INC.
DOCKET NO. 980307-WS
WATER NET OPERATING INCOME
PERIOD ENDED DECEMBER 31, 1996**

(a) DESCRIPTION	(b) PER COMPANY	(c) AUDIT EXCEPTION (1)	(d) REFER TO (2)	(e) PER AUDIT
OPERATING REVENUES	\$104,667.00	\$0.00		\$104,667.00
OPERATING EXPENSES:				
O&M EXPENSE	169,841.07	(68,111.11)	E-4	96,378.93
		(2,323.27)	E-5	
		(2,851.84)	E-6	
		(175.92)	E-7	
DEPRECIATION EXPENSE (3)	82,967.00	(81,430.40)	E-2	1,543.93
		7.33	E-7	
TAXES OTHER THAN INCOME	390.50	0.00		390.50
INCOME TAX EXPENSE	0.00	0.00		0.00
TOTAL OPERATING EXPENSE	\$253,198.57	(\$154,885.21)		\$98,313.36
NET OPERATING INCOME(LOSS)	(\$148,531.57)	\$154,885.21		\$6,353.64

REQUIRED FOOTNOTES:

(1) *Small differences are due to rounding.*

(2) *Audit adjustments do not include audit disclosures.*

EXHIBIT IV

**ZELLWOOD STATION CO-OP, INC.
DOCKET NO. 980307-WS
WASTEWATER NET OPERATING INCOME
PERIOD ENDED DECEMBER 31, 1996**

(a)	(b)	(c)	(d)	(e)
DESCRIPTION	PER COMPANY	AUDIT EXCEPTION (1)	REFER TO (2)	PER AUDIT
OPERATING REVENUES	\$104,667.00	\$0.00		\$104,667.00
OPERATING EXPENSES:				
O&M EXPENSE	167,421.93	(77,369.00)	E-4	104,177.84
		14,712.48	E-5	
		(587.57)	E-7	
DEPRECIATION EXPENSE (3)	89,077.00	(88,552.04)	E-2	541.39
		16.43	E-7	
TAXES OTHER THAN INCOME	3,409.50	0.00		3,409.50
INCOME TAX EXPENSE	0.00	0.00		0.00
TOTAL OPERATING EXPENSE	\$259,908.43	(\$151,779.70)		\$108,128.73
NET OPERATING INCOME(LOSS)	(\$155,241.43)	\$151,779.70		(\$3,461.73)

REQUIRED FOOTNOTES:

(1) *Small differences are due to rounding.*

EXHIBIT V

**ZELLWOOD STATION CO-OP, INC.
DOCKET NO. 980307-WS
CAPITAL STRUCTURE (1)
PERIOD ENDED DECEMBER 31, 1996**

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
DESCRIPTION	PER COMPANY	AUDIT EXCEPTION (1)	REFER TO	PER AUDIT	RATIO	COST RATE	WEIGHTED COST OF CAPITAL
COMMON EQUITY	\$0.00	\$76,064.05		\$76,064.05	88.97%	8.68%	7.72%
LONG-TERM DEBT	0.00	9,429.99		9,429.99	11.03%	7.00%	0.77%
CUSTOMER DEPOSITS	0.00	0.00		0.00	0.00%		0.00%
	<hr/>	<hr/>		<hr/>	<hr/>		<hr/>
TOTAL	\$0.00	\$85,494.04		\$85,494.04	100.00%		8.49%

REQUIRED FOOTNOTES:

(1) *Audit adjustments do not include audit disclosures.*

STATE OF FLORIDA

Commissioners:
JULIA L. JOHNSON, CHAIRMAN
J. TERRY DEASON
SUSAN F. CLARK
JOE GARCIA
E. LEON JACOBS, JR.



DIVISION OF RECORDS & REPORTING
BLANCA S. BAYÓ
DIRECTOR
(850) 413-6770

Public Service Commission

July 28, 1998

W. A. Restall, Utilities Director
Zellwood Station Co-Op, Inc.
2126 Spillman Drive
Zellwood, Florida 32798-9797

Re: Docket No. 980307 - WS - Zellwood Station Co-Op, Inc.
Audit Report - Establish Rate Base - Period Ended December 31, 1998
Audit Control # 98-095-3-1

Dear Mr. Restall:

The enclosed audit report is forwarded for your review. Any company response filed with this office within ten (10) work days of the above case will be forwarded for consideration by the staff analyst in the preparation of a recommendation for this case.

Thank you for your cooperation.

Sincerely,

A handwritten signature in cursive script that reads "Kay Flynn".

Kay Flynn

KF/ABF
Enclosure

cc: Public Counsel
Division of Audit and Financial Analysis
Thomas A. Cloud